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DOW THEORY LETTERS

"THE MARKET AS INTERPRETED UNDER THE DOW THEORY"

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THIRD PHASE. We are now in the third or last phase of history's greatest bull market. This is the most profitable and spectacular phase; it is also the most dangerous. For in the third phase any secondary reaction may later prove to have been the first leg of a primary bear market. Herein lies the problem and the danger.

There is nothing in the writings of Hamilton or Rhea that even remotely suggests waiting for a bear signal before selling out. On the contrary, they constantly suggested the wisdom of retreat after long advances in a bull market. Many readers (and this writer) have held securities since the primary trend turned up in 1949. Others have owned stocks throughout the historic 170 point advance which followed the October, 1957 lows. Our tax liability is now very large; retreating before a possible secondary reaction would entail paying Uncle Sam a fat sum as "insurance" against a bear market. For a decade we have watched the market bottom-out on each decline or reaction, then advance to new highs as the primary force reasserted itself.

It is the third phase of a bull market, however, which proves the eventual downfall of many investors. After years of successive price rises we bulls fatten, our confidence grows, and greed becomes the master of caution. It is at such times that the day of final reckoning is usually drawing near. We should never forget that, under Dow Theory, each bullish signal in a primary bull market holds progressively less validity. Finally, we will receive a bullish signal which will be the last one; the great primary force will have spent itself. The stock market barometer, like the weather barometer, can point to fair weather, then reverse itself in a day. Therefore, as the market works higher our attention should be more and more directed to avoiding the bear swing that must eventually come. There is only one way to do this, and that is to check our greed and learn to practice the art of strategic retreat. This necessitates a difficult course--selling too soon.

Many Dow Theorists automatically take profits after a long uncorrected advance. Others prefer to sell stock (particularly in a third phase) on the advent of anything that appears to be a coming secondary reaction. After a prolonged upward swing one or more of the following may tip off a secondary. (1) Excessive volume (relative to that which preceded) with little or no advance in the averages. (2) One average declines persistently while the other advances. (3) Following a decline, an advance commences in which one or both averages fail to go over a previous high, and then the two averages violate their previous decline level on increasing volume. (4) One average goes to a new high but the other refuses to confirm or agree. (5) Both averages break a "line" downside (a line is a formation in which each respective average remains within a 5% area for at least two weeks).

TECHNICAL INDICATORS. There is no questioning the fact that the crowd is climbing aboard this market in ever increasing numbers. Speculation is in the air, "hot tips" are plentiful, the butcher and baker are offering the latest rumors along with the pork chops and rolls. Many amateurs who have never before owned securities are becoming avid buyers of stocks. Dow Theorists always feel a little uneasy when the party turns into a brawl. It is beginning to assume that aspect now.

The odd-lot trader (under 100 shares) has recently been buying on balance; he will probably continue to buy right up to the top. The short position, although still very large, is in a downward trend. As prices advance the financial writers are turning bullish, always a signal for caution to the experienced investor. There is no unanimous bullishness as yet; most analysts still do not envision a coming boom. But they will in time, and the flames will undoubtedly be fanned when these analysts announce to the world the events which the

Dow Theorists predicted months ago. The yield on the Dow-Jones Industrials is now about 3.4%, a clear caution sign. Rising dividend payouts may increase this yield to some extent, but anything under 3.5% should be treated as a "go-slow" signal.

This letter does not imply that a bear market or even a secondary reaction is upon us. I am not being contradictory when I say that in my opinion this market has another year to go, and the industrials could probe the 700-800 area. However, opinion and preconceived ideas, no matter how well-founded, will never take precedent over the verdict of the averages. I want no readers caught in a bear market because they placed judgment over the Dow Theory. We are in the last phase of a bull market, and that is the one overriding fact of importance.

It is interesting to note that the third phase is not characterized by violent or severe secondaries. On the other hand, it is the area where the crowd owns a great deal of stock, and we may expect erratic moves as well as extreme sensitivity to any unexpected news events. We should remember as the market approaches the boiling point that every ten points higher is ten points nearer the top, not ten points nearer the sky.

PRICE MOVEMENTS. Following last week's sudden drop of $8.00 in the industrials, both averages climbed higher, rails to their highs for the year and industrials to new all-time highs. Early this week as the market declined on bullishly decreasing volume, rails virtually refused to give ground. Wednesday and Thursday saw rails leap to successive new highs as industrials followed to close at all-time highs again. The rail showing has been tremendous; they have been the strength of the market. Volume has been expanding with higher prices and both averages have been advancing "in gear", a promising indication of further near-term gains.

STOCKS. The following stocks look bullish from a technical standpoint: CHEMETRON, ADMIRAL, DOW, WESTINGHOUSE, AMERICAN SMELTING. STUDEBAKER-PACKARD is extremely interesting; the chart implies it will break out of its top at 16. If it does, there should be fireworks as the shorts scramble to cover. It's a real speculation, but a good one.

I do not like THOMPSON-RAMO, MARTIN, NORTH AMERICAN, LITTON.
(written Jan. 15th, 8:00 P.M.)

I am sorry that I do not have time to answer the numerous questions which are submitted to me daily. I believe most of these questions will be answered in these letters during the course of the year.